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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1954

No. 610

STOCKTON HARBOR INDUSTRIAL COMPANY,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

PETITIONER'S BRIEF IN REPLY TO BRIEF IN OPPOSITION.

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We believe that consideration of the case will be helped by a few comments in reply to the brief in opposition.

1. One reorganization issue turns on whether or not there was an "assumption" by petitioner of the $25,655.77 of Lindley Patrick liabilities which the escrow agent paid with cash supplied by petitioner. The Government argues that there was an "assumption" (Brief Opp. p. 15).

If there was an "assumption" of liability herein, then there was one as well in *Southwest Consolidated,*[1] in *Cen-*

[1] *Helvering v. Southwest Consolidated Corporation,* (1942) 315 U.S. 194.

tral Kansas,[2] and in *Adwood,*[3] for in all of them the relevant facts were the same as here: in each case the transferee supplied cash to an intermediary acting for both transferor and transferee, and in each case the cash was intended to be and was actually used to pay debts of the transferor which had arisen before the reorganization and which had put the transferor in its financial predicament. This Court in *Southwest Consolidated,* and two different appellate courts in *Central Kansas* and *Adwood,* held that these facts did not constitute an "assumption" of liability.[4] The court below held the identical facts did constitute an "assumption". The conflict is inescapable.

The Government's argument that herein there was an "assumption" and therefore the case was correctly decided below merely amounts to an argument that this Court was wrong in *Southwest Consolidated.* The error of the Government's argument is the same as that of the lower court.[5] It consists of confusing the two steps in this Court's reasoning in *Southwest Consolidated,* only the first one of which is relevant herein. First, this Court held that the payment by the transferee of some of the transferor's debts with cash spoiled the reorganization because an acquisition for stock plus cash was not "solely for . . . stock" as the statute requires. Second, this Court dealt with a problem not presented herein, that the cash

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[2]*Central Kansas Tel. Co. v. Commissioner,* (CA 10, 1944) 141 F. 2d 213.

[3]*Adwood Corporation v. Commissioner,* (CA 6, 1952) 200 F.2d 552.

[4]In each of those cases the Government successfully denied that these facts constitute an "assumption". Here it has argued the contrary, but again with success.

[5]This error was, we believe, exposed at pp. 15-16 of our petition.

could be treated as an "assumption" of a debt and therefore disregarded because it had been raised through the medium of a bank loan negotiated by the trustee in the course of the reorganization, and the transferee had "assumed" the bank loan.

The portion of the *Southwest Consolidated* opinion quoted at pages 14-15 of the brief in opposition deals only with the second point involved therein, which is not presented by the instant case. This language misled the lower courts herein. However, a reading of the entire portion of the *Southwest Consolidated* opinion dealing with this issue should make the validity of our position clear. That portion is short. We have reproduced it in the Appendix hereto. To facilitate reading, we have emphasized the portion of it quoted in the brief in opposition, as well as the additional sentences which we believe should be read to make this Court's meaning clear.

It has always seemed to us that this Court's opinion in *Southwest Consolidated* was entirely clear. Since, however, it can be the subject of such conflicting interpretations, this is evidently not so. The clarification of Supreme Court interpretation of statutory provisions can hardly be expected of Congress. We submit that this Court should remove both the conflict and the uncertainty which appears to exist of its meaning in *Southwest Consolidated.*

2. The argument seeking to dismiss our contentions concerning the effect on Section 368(a)(2)(B) of the 1954 Code of the doctrine enunciated below (Brief Opp. p. 16) suggests that in our efforts to compress what we felt was an overlong petition we omitted some necessary explanation.

Let us assume a "thin corporation", i.e., one in which the shareholders are the creditors as well, and the debt capital, represented entirely by long-term indebtedness, exceeds the equity capital. Under the decision below, the shareholders-creditors of the transferor can receive stock in the transferee in exchange for their stock, cash from the transferee in complete repayment of the loans, and pay no tax on their profit. They could not do so under Section 368(a)(2)(B) because the transaction could not comply with its requirements. Under the decision below, they could do so under the Hendler amendment, which respondent correctly states is carried forward into the 1954 act. And this in the face of the fact that the Hendler amendment was deliberately framed by Congress so as to be inapplicable to the cash payment of debts.[6]

The error below therefore opens up a significant loophole which Congress did not intend.

3. The Government argues that the capital gain question is simply one of fact and does not challenge our interpretation of the decisions below. We contend that there is an issue of law in the proper interpretation of the statute in the light of its legislative history. The brief in opposition has refused to discuss our analysis of the damaging potentialities of the decision below on the law in this area.

We believe that our further contentions concerning the scope of review are adequately presented in the petition and that their perhaps confusing merger in the brief in

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[6]Surrey, *Assumption of Indebtedness in Tax Free Exchanges*, 50 Yale L.J. 1, 17, footnote, states that this legislative decision was made "in order to minimize possible tax avoidance."

opposition does not prevent their being easily enough seen and decided. It appears to us that the brief in opposition overlooks that even if the capital gains issue be entirely one of fact, the reviewing court is obligated to examine the entire record and not, as the lower court here did, merely the portion favorable to the decision under review. The major omission in the argument it makes, however, is in failing to see that the cases we cited as establishing the conflict reversed the lower court because the finding in the language of the statute, however epitomized, could not be supported under the correct legal criteria for its application, whereas the decision below treats it as a pure question of fact which the Tax Court could have decided either way without presenting an appealable issue.

CONCLUSION.

The petition should be granted.

Dated, San Francisco, California,
March 30, 1955.

Respectfully submitted,
VALENTINE BROOKES,
ARTHUR H. KENT,
Attorneys for Petitioner.

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[7]The Clerk has called our attention to our failure to include the judgment of the Court of Appeals in the Appendix of the petition, conformably to Rule 23(1)(j). It is therefore printed in Appendix B hereto.

(Appendices A and B Follow.)

Appendix A

Excerpt from opinion in *Helvering v. Southwest Consolidated Corporation,* 315 U.S. 194, at 198-200:

"Congress has provided that the assets of the transferor corporation must be acquired in exchange 'solely' for 'voting stock' of the transferee. 'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement. See Hendricks, Developments in the Taxation of Reorganizations, 34 Col. L. Rev. 1198, 1202-1203. Congress, however, in 1939 amended clause (B) of § 112(g)(1) by adding, 'but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded.' 53 Stat. 871, 26 U.S.C.A. Int. Rev. Acts, page 1177. That amendment was made to avoid the consequences of United States v. Hendler, 303 U.S. 564, 58 S.Ct. 655, 82 L. Ed. 1018. See H. Rep. No. 855, 76th Cong., 1st Sess., pp. 18-20; S. Rep. No. 648, 76th Cong., 1st Sess., p. 3. And it was made retroactive so as to include the 1934 Act. 53 Stat. 872, 26 U.S.C.A. Int. Rev. Acts, page 1178. But with that exception, the requirements of § 112(g)(1)(B) are not met if properties are acquired in exchange for a consideration other than, or in addition to, voting stock. Under that test this transaction fails to qualify as a 'reorganization' under clause (B).

"*In the first place, security holders of the old company owning $440,000 face amount of obligations were paid off in cash. That cash was raised during the reorganization on a loan from a bank. Since that loan was assumed by respondent, it is argued that*

the requirement of clause (B), as amended in 1939, was satisfied. But in substance the transaction was precisely the same as if respondent had paid cash plus voting stock for the properties. We search the legislative history of the 1939 amendment in vain for any indication that it was designed to do more than to alter the rule of the Hendler case. That case dealt with a situation where an indebtedness which antedated the transaction in question was assumed by the transferee. There the debt assumed clearly was a 'liability of the other' corporation. The situation here is quite different. The rights of the security holders against the old corporation were drastically altered by the sale made pursuant to the plan. The sale not only removed the lien from the property and altered the rights of the security holders in it; it also limited and defined the rights of the individual creditors if they elected to take cash rather than participate in the plan. See Weiner, Conflicting Functions of the Upset Price, 27 Col. L. Rev. 132, 137-138. In Helvering v. Alabama Asphaltic Limestone Co., supra, we regarded the several steps in a reorganization as mere 'intermediate procedural devices utilized to enable the new corporation to acquire all the assets of the old one pursuant to a single reorganization plan.' *Under that approach part of the consideration which respondent paid for the properties of its predecessor was cash in the amount of about $106,680. The fact that it was paid to the bank rather than to the old corporation or its creditors is immaterial. The requirement to pay cash arose out of the reorganization itself.* It derived, as did the requirement to pay stock, from the plan pursuant to which the properties were acquired. It was a necessary incident of the court decree which wiped out the liability of the old corporation and substituted another one in its place.

Though the liability assumed had its origin in obligations of the transferor, its nature and amount were determined and fixed in the reorganization. It therefore cannot be labelled as an obligation of the 'other' or predecessor corporation within the meaning of the 1939 amendment. Nor can the property be said to have been acquired 'subject to' that liability within the purview of that amendment. The words 'subject to' normally connote in legal parlance an absence of personal obligation. That seems to be the case here, for the preceding clause of the amendment covers the case of 'assumption'." (Emphasis ours.)

Appendix B

United States Court of Appeals
For the Ninth Circuit

STOCKTON HARBOR INDUSTRIAL COMPANY, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 13615.

JUDGMENT.

Upon petition to review a decision of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the decision of the said Tax Court of the United States in this cause be, and hereby is affirmed.

(Endorsed:) Judgment. Filed and entered November 1, 1954, Paul P. O'Brien, Clerk.